# SUMMARY ANALYSIS OF AMENDED BILL

**Franchise Tax Board**

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Related Bills: See Prior Analysis    Telephone: 845-6979    Amended Date: 06/26/2000

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**SUBJECT**: Biotechnology Company Research Expenses Credit Allows Transfer of Unused Tax Benefits/FTB Report Annually Regarding Utilization of Transfer

_____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended __________.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended __________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO ______________________.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED ___________ STILL APPLIES.

_____ OTHER - See comments below.

SUMMARY OF BILL

Under the Bank and Corporation Tax Law (B&CTL), this bill would allow a biotechnology company with unused tax benefits (research credit carryovers and net operating loss (NOL) carryovers) to transfer those benefits to specified corporations for at least 75% of the value of the unused tax benefit.

SUMMARY OF AMENDMENT

The June 26, 2000, amendments made the following changes:

?? Deleted the provisions providing for a refund of unused tax benefits and replaced it with a transfer of unused tax benefits to specified corporations.
?? Removed "technology companies" from the bill.
?? Capped the total value of tax benefit transfers at $25 million annually and capped the amount each biotechnology company taxpayer may transfer annually at $500,000.
?? Removed the requirement that the department track unused tax benefit refund amounts.
?? Added a requirement that the department report annually regarding the transfer of unused tax benefits.

The "Effective Date," "Legislative History" and current law discussion in "Specific Findings" of the department's analysis of the bill as introduced February 24, 2000, still apply. The remainder of that analysis and the analysis of the bill as amended May 18, 2000, are replaced with the following.

| Board Position: | | | Legislative Director | Date |
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| _____ S | _____ NA | _____ NP | Johnnie Lou Rosas | 7/20/00 |
| _____ SA | _____ O | _____ NAR | | |
| _____ N | _____ OUA | X PENDING | | |

## SPECIFIC FINDINGS

**Under the B&CTL, this bill** would allow biotechnology companies with unused tax benefits (research and development credit carryovers and NOL carryovers) to transfer those benefits to a corporation that is a biotechnology company, bioscience company or contract research organization that is not affiliated with the transferor taxpayer and that pays an amount equal to at least 75% of the value of the unused tax benefit. The transfer provisions would apply only to biotechnology companies taxable as corporations that are engaged in research and development activities regarding organisms or materials derived from organisms, and their components, to provide pharmaceutical products or regarding recombinant DNA technology to produce commercial products or pharmaceutical delivery systems.

The total amount of unused tax benefits that may be transferred by all taxpayers under this bill is $25 million annually. Individual biotechnology companies may transfer no more than $500,000 of unused tax benefits annually.

For purposes of determining whether a transfer may be made under the bill's provisions, a corporation is treated as affiliated with the taxpayer transferor if either: (1) the taxpayer transferor directly or indirectly owns or controls 10% or more of the voting rights or 10% of the value of all classes of stock of that corporation, or (2) another organization directly or indirectly owns or controls 10% or more of the voting rights or 10% of the value of all classes of stock of both the taxpayer transferor and that corporation.

### Policy Considerations

This bill would set the maximum annual transferred benefits at $25 million annually, which term is not defined but the department assumes is intended to refer to a calendar year. As a result, the bill would provide an inherent advantage to taxpayers with income years ending early during the calendar year because they would be able to transfer their tax benefits before those with an income year ending later during the calendar year and before the annual maximum amount would be reached.

This bill would provide a tax benefit for taxpayers filing under the B&CTL that would not be provided to other similarly situated taxpayers that file under the Personal Income Tax Law (PITL). Thus, this bill would provide differing treatment based solely on entity classification. Further, it is unclear how the benefit would apply to S corporations and their shareholders.

### Implementation Considerations

Department staff has identified the following implementation considerations. Additional concerns may be raised as the department continues to analyze the bill. Department staff is willing to assist the author with any necessary amendments to resolve these concerns.

1. The bill imposes an annual limit on the total amount of unused tax benefits that may be transferred and the amount of unused tax benefits that a biotechnology company may transfer. However, the bill does not provide a mechanism (e.g., pre-transfer approval, certification, or otherwise) to implement this limitation. In the absence of some process to implement these annual limitations, taxpayers would be unable to determine if a transfer of unused tax benefits was effective and would entitle the transferee to claim the tax benefits on their own tax return.

2. It is unclear how the $25 million annual aggregate limit applies. For example, the bill does not specify how the $25 million annual aggregate limit would be allocated among taxpayers if the limitation amount were exceeded. Moreover, as noted above, since the term "annual" is not defined in the bill, it might be interpreted as the calendar year, as the department has assumed in analyzing this bill, or it might mean the state's fiscal (budget) year. Undefined terms may lead to disputes between taxpayers and the department.

3. This bill would require a payment to a taxpayer transferor in exchange for unused tax benefits. The tax treatment of this payment is unclear. Would the receipt of the payment be income and the payment a business expense? Further, the bill requires that the taxpayer transferee pay an amount equal to at least 75% of the "value" of the tax benefits transferred, but does not specify how that value is to be determined.

4. This bill uses various terms that are not defined, such as "corporation business taxpayer in this state," "new drug," and "new biological or medical device." Further, terms are used inconsistently and in an unusual context that add confusion to the provisions. Undefined terms and unclear definitions can lead to disputes between taxpayers and the department.

5. This bill does not address whether the entire unused tax benefit or portions of the unused tax benefit may be transferred.

6. The requirement that the department report to the Legislature states that the information to be reported include the "impact of the unused tax benefit transfer program on clinical trials by biotechnology companies." Department staff would not have information necessary to make this determination.

7. Subdivision (c) of the bill specifies that the bill applies only to "companies **conducting** clinical studies on a new drug or a new biological or medical device." It is unclear whether this applies to transferees in addition to transferors. If it does apply to transferees, the definitions of "contract research organization" or a "bioscience company" would likely prevent them from qualifying for this provision since the definitions do not require the companies to conduct research.

Technical Considerations

1. In defining "unused tax benefits," this bill refers to provisions of Section 23609, which prescribe carryover rules, but erroneously references subdivision (d) of Section 23609 rather than subdivision (f).

2. On page 3, line 31, the word "that" following "(B)" should be deleted as surplus language.

## LEGISLATIVELY MANDATED REPORTS

This bill would require the department to report to the Legislature annually on the utilization of the transfer of unused tax benefits. The report would include information regarding the total value of the unused tax benefits transferred, the total number of taxpayers transferring unused tax benefits, the amount paid by transferees, the impact of the unused tax benefit transfer program on clinical trials by biotechnology companies, and any other information helpful in evaluating the usefulness of the transfer program.

## FISCAL IMPACT

### Departmental Costs

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved.

### Tax Revenue Estimate

The revenue estimate for this bill cannot be determined at this time.

It is not possible to predict in advance what the response of taxpayers would be to the authorization of credit transfers. Further, the implementation issues, discussed above, regarding the tax treatment of payments made and received for transfers and the annual limitations need to be resolved.

It is projected for income years beginning in 2000 that biotechnology corporations would have about $450 million in unused research and development credits and $880 million in NOL carry-over deductions that could qualify for transfer under this bill.

## BOARD POSITION

Pending.